THE THEORY OF PROFIT-SHARING.

If there is any sound theoretical basis for the plan of profit-sharing, some exposition of it is called for by the publication in the *Quarterly Journal of Economics* of a criticism in which the general conclusion is affirmed that there would seem to be "theoretical reasons for doubting the justice, the reasonableness, and the efficiency of the scheme as a possible re-arrangement of the industrial system." By theoretical reasons, *a priori* reasons are meant. The point is well taken in Mr. Aldrich's paper that, in current discussion, the advocates of profit-sharing base their argument, for the most part, upon cases in which the scheme has been adopted, but that those cases are too few and exceptional to serve as a sufficient basis for an induction of such magnitude as one concerning a possible re-arrangement of the economic system of society.

This reminder that a scientific justification of profit-sharing must be a deductive one should be welcomed. Any complete theory must admit of deductive formulation, since it is only through deduction that generalizations, inductively established, are correlated with wider and the widest truths, and scientific principles, strictly so called, are ascertained. And, if profit-sharing is wrong in principle, the sooner we have done with it, the better.

On *a priori* grounds, then, I think it can be successfully maintained that profit-sharing is presumptively a better arrangement, economically and morally, than the simple wages system: (1) because a legitimate deduction from those principles of human nature that are the premises of deductive economics is that more wealth will be produced under profit-sharing than under the unmodified wages system; (2) because a legitimate deduction from the postulate of distributive ethics and one of the cardinal truths of political economy is that profit-sharing effects a more equitable distribution than can be effected by the unmodified wages system.

A premise of all deductive economics is that self-interest is the chief motive in the creation of wealth. If this premise is valid, the wages system, judged by an absolute standard, is

uneconomical. It enlists the self-interest of the wage-earner but partially. The great moral forces of his personality are not called into creative action. The fixed amount of his wages measures the effort that he feels disposed to make. On the other hand, the effort of the worker whose reward is to be a profit in some degree proportionate to his achievement is limited only by the limitations of his own physical, mental, and moral powers. The most that could be shown for the wages system would be that it was relatively economical; that, in consequence of certain concrete facts, it proved to be, in practice, more economical than any known and tried substitute. But this could be proven only by induction, and the burden of proof would be on those who should deny the valid deduction that a system that enlists self-interest more than the wages system enlists it ought to be more economical. The data for such an induction are incomplete, as has been admitted; but, so far as they exist, they verify the deduction. The presumption, therefore, is that profit-sharing is more economical than the unmodified wages system.

The postulate of any sound theory of the ethics of distribution is that every productive worker should be rewarded according to the real worth of his services to society. Any other postulate means communism. But, if we accept this postulate, we are compelled to make damaging admissions in regard to the ethics of distribution under the wages system.

When the rate of profits is such that the competition of employers, in their effort to secure workmen, increases, causing them to accept a smaller fraction of net product as their profit, and to allow a larger fraction for wages, there are two hypothetical possibilities to be considered. Either the increase of profits is instantly offset by a rise of wages or the rise of wages is only after a certain time. To affirm that the causation is instantaneous is to eliminate the element of time from the process of competition,—a palpable absurdity. If the rise of wages is only after a certain time, we must admit either that the rate of profits *has been* too high and the rate of wages too low to correspond with the ethical standard, or that competition is now working injustice by rewarding labor

in excess of its deserts at the expense of the employer, who is obliged to accept less than his deserts. A cardinal principle of deductive economics is that competition does, in the long run, and in the average of cases, reward men according to the relative values of their services, but that this action of competition may be imperfect in the particular case. So far as it is imperfect, the wages system is ethically defective. Assuming that, in the average of cases, the action of competition realizes the ethical ideal, it follows that, in the average of such cases as we have just supposed, the rate of profits *has been* too high and the rate of wages too low to correspond with the ethical standard. That is, we are compelled to admit that profits may contain at any given time a sum in excess of the normal equitable reward of the services rendered by the employer,—a sum which it will be the function of further competition to distribute with approximate equity.

What is the origin of this sum? In some form, it is contained in the value of the net product of industry. The problem is to distinguish it from interest and the legitimate reward of the employer functions, and to see in just what way it comes into existence.

Wages are not only not paid out of capital, but, as Professor Henry Sidgwick has shown, they are not so much as advanced out of capital. Strictly speaking, they are simply capital in one form exchanged for capital in another form, the latter being the utility created by the laborer.

But the price at which the utility created by the laborer will sell may not be known when the wage is paid. Wages may be paid on the basis of a probable minimum price. The employer may reason: "This product will doubtless sell for at least so much. This price must afford me my reward for the industrial services that I render, interest on the capital that I employ, rent and incidental expenses, and something towards the fund reserved against losses. The remainder I can pay out in wages. More than this remainder I shall not pay, unless compelled to do so by other considerations than the immediate value of my business to myself. My demand for labor stops at this point; since, if I pay more, the excess

must come out of the sum that I consider the rightful reward of my own services."

Nevertheless, the employing producer conducts his business in the hope that the actual price his goods will fetch will exceed this minimum, hypothetical price, to which he adjusts his scale of expenses; and, when prices are rising, the hope is fulfilled. His profits then include a sum entirely distinct from the reward of his industrial functions already provided for. It is an increment due solely to social changes of one or another kind, which have increased the demand for his goods and raised their price. While the product of industry, considered as concrete wealth, is created by the combined efforts of labor, capital, and management, there is a coefficient in the value of this product that is created by the social organism as a whole.

This coefficient is sometimes a negative one. A rhythm of alternately rising and falling prices is an inevitable phenomenon in commercial communities. When prices are rising, the expectation that the rise will continue leads to speculative production and buying. Goods are produced and bought to be sold at the higher price looked for. Reservoirs of goods, stored up for future sale and use, are thus created. When the point is reached where the least daring buyers cease to buy, the price ceases to rise. All speculative buying stops. The expectation of a rise changes to the expectation of a fall, and the universal desire to sell before the price has fallen so far as to cancel all the gains of the rise, hastens the fall. So long as goods remain in the wholesale and retail reservoirs in excess of the demand for current consumption, prices will continue to fall. When the surplus stores are exhausted, the mercantile expectation swings back to an anticipation of rising prices, and speculative operations begin again. So occur the rhythms of industrial booms and depressions concerning the causes of which there has been so much discussion. Generically, they are the necessary results of normal human motives acting in accordance with normal calculations of probabilities. They may be intensified or moderated by the action of co-operating causes.

In the community at large, population remaining constant, the gains and losses by rising and falling prices must balance each other; but there is no necessary equivalence of gains and losses in the transactions of the employing producer. On the contrary, the mercantile art, the practice of which is one of the chief functions of the employing producer, consists to no small extent in securing the gains and avoiding the losses made by price fluctuations. Different industrial classes have in very different degrees the quality of economic elasticity; that is, the power of reacting upon and transmitting the various forms of economic shock and pressure. This power is least among the consumers of final utilities and the producers of the primary utilities,— raw materials and crude work; and upon these classes, therefore, the major part of all losses ultimately falls. Wealth is not created by speculative production and exchange. It is only transferred from the ownership of the timid and uninformed, and those whose necessities are pressing, to the ownership of those who are bold, well-informed, far-sighted, skilful, and in command of ample resources. Through the speculative buying of the laborer's work, a part of the price which society as a whole pays for that work is transferred from the laborer to his employer.

There is another sum that tends to find its way into the employer's gains, as an addition to the normal reward of his services, which is created by the mere growth of society, apart from any advance in prices. Social growth creates a demand for a constantly increasing quantity of every sort of staple goods. The greater the quantity demanded and sold, the less is the cost of production per unit of product. Not that the mere multiplication of human beings is itself creative of wealth, but that the multiplication of utilities by the productive labor of additional human beings enhances the utility created by each one. It does this by creating the means for more perfectly utilizing all labor and all means of production. Prices of goods and wages of labor remaining the same, the employer's gains per unit of product would constantly increase, in an advancing society.

Actually, prices of goods and wages of labor cannot remain

the same. Competition inevitably distributes these gains, and the increase of wealth by the more perfect utilization of labor and capital in consequence of social growth becomes the source of increasing wages and falling prices.

In so far as values created by social changes are distributed among all classes in proportion to the worth of their services, the ethical requirement is met. A certain ratio must exist between the average consumption and the average production of any aggregate of men, and a distribution on the double basis of production and consumption should be found to be approximately proportionate to the worth of the services. But competition is a defective process for effecting such a distribution. We have already noted that the competitive process takes time. It is only after gains in excess of the normal reward of his functions have gone into the hands of the employing producer that competition begins.

When actual competition does begin, it goes to excess in proportion to the excessiveness of previous gains. Normal profits may be now encroached upon, and the losses so incurred may fully offset the previous excessive gains. But the important fact is that the wage-worker and the consumer get no wrongs righted. The excessive competition, instead of correcting the distributive error already made, doubles it. President Francis A. Walker has shown that the profits of employers of different degrees of ability vary in accordance with the same principle that governs the rent of lands of unequal degrees of fertility. Whatever brings a new margin of inferior soil under cultivation increases the rent of all lands of better quality. Whatever brings into the class of employers those men whose business abilities are so small that ordinarily they would find their place as employees raises the profits of the employers of superior abilities. Conversely, we may say with equal truth that, when the profits of the superior employers are in excess of the normal reward of their functions, men of inferior abilities, who otherwise would remain employees, will be drawn into the employing class, and that the costs of production borne by the community at large will be correspondingly increased. When, in consequence of excessive competition, bankruptcies

follow and capital is destroyed, the productive power of the community is impaired, and workmen are thrown out of employment.

To summarize: Competition begins only after gains in excess of normal profits have accrued to employing producers. As a consequence of this fact, when competition does begin, it goes to excess. As a further consequence, capital is wasted and the cost of production is increased. Thus, the movement of competition, like the movement of prices, inevitably assumes a rhythmical form. The losses that multiply during the period of excessive competition fall mainly on the producers of primary utilities and the consumers of final utilities. The gains that are made during the period of deficient competition accrue chiefly to those who occupy the middle places in the industrial series and exercise mercantile functions as producers and exchangers of secondary and final utilities. Therefore, beyond that ethical defectiveness of competition due to the unequal competitive abilities of the rich and the poor, the well-informed and the ignorant, which has been often recognized, the competitive process itself is inherently defective, ethically and economically, as a distributive agency.

Making no attempt to do away with or limit competition, profit-sharing corrects the radical defect of competition at the points where the defect arises. To the time element and the element of indirectness the inherent defects of competition are due. Profit-sharing as a distributive agency simply eliminates the elements of time and indirectness from the distributive process. It divides immediately upon its production and directly among the rightful beneficiaries, in proportion to their services, the value created by social growth and change, which otherwise would be divided tardily and indirectly, and therefore imperfectly, by competition.

Acknowledging the approximate equity of distribution by competition, profit-sharing accepts this distribution as the basis of its own anticipatory, supplementary, and corrective distribution. The *bonus* to workers is divided on the basis of their wages; the *bonus* to consumers, on the basis of their purchases. Logically, this principle ought to be observed

more strictly than it usually is. The question is often asked, "In what proportions should the surplus be divided among workers, stockholders, and managers?" Obviously, in the proportions that wages, salaries, and interest bear to each other interest being proportionate to the risks of the investment. For example, if the wages paid by a corporation amount to $100,000 a year, the interest on the capital employed is $20,000, and the salaries aggregate $20,000, the net profit remaining after these sums have been paid should be divided in the proportions 5, 1, and 1. Logically, too, there should be a dividend to the customer, as in distributive co-operation, which should take the place of all discounts on large sales. English co-operators contend that capital *per se* should not share in the *bonus*. If a secured loan, it should not. If exposed to the risks of the business, it should.

What are the theoretical objections to profit-sharing?

It is not a valid objection that profit-sharing is, and may be always, a plan of partial or occasional application, and not the prevalent industrial system. It is legitimate to inquire what favorable reactions upon the wages system may be expected from the adoption of profit-sharing by any influential portion of the employing class.

It is not a valid objection to say that wages are a commutation of the workman's theoretic share of the industrial product, the sum deducted being the premium paid for the insurance of that share, the employer assuming all risks of loss. Wages paid in connection with profit-sharing are not a commutation. They are a partial payment of the workman's theoretic share, as the sums taken by the employer in the form of salary or otherwise for his current personal expenses are a partial payment of his theoretic share. Workman and employer both may receive, ultimately, the remainder of their theoretic shares, or they may find that they both have worked to some extent for nothing. But, if one loses, the other loses. Their risks are the same.

It is not easy to see how wages can be regarded as a commutation in any case, so long as the employer claims and exercises the right to reduce them at will. To make a com-

parison, what sort of fire insurance would that be in which the insurers reserved the right to deduct a per centum from the face of every policy, whenever the year's business looked unpromising, agreeing to restore it when business was better? The insured might possibly suspect that they bore a part of the risks themselves.

If by risk any objector to profit-sharing means the risk that the employer incurs of losing not only a part of his rightful share in the industrial product, but also a part of his past accumulations, and the objection is urged that there can be equitably no profit-sharing unless the employee can and does become liable for a part of such losses, the reply is that the objector confounds two distinct things. If, besides the share of the industrial product that rightfully should go to him as a workman, the employee is to receive also a part of the share that properly belongs to the undertaking capitalist, he should be liable with the *entrepreneur* for losses of capital, but not otherwise. This distinction marks the difference between simple profit-sharing, which we have been considering, and the industrial partnership, properly so called,— a higher and more complex industrial organization.

Any practical difficulties that there might be in maintaining a good understanding between employers and employees as to the right distribution of gains and losses, would afford no theoretical objections to profit-sharing. An objection on this account could be raised and answered only by an inductive study of actual experiments, and these, so far, do not sustain such objections.

There is no valid objection to profit-sharing in the fact that the dividend on wages may nearly or quite disappear, as in the case of the Paris and Orleans railway. If the distribution has been put on the right basis at the outset, the disappearance of the *bonus*, the business being prosperous, can have no other significance than as showing that the preliminary distribution in wages, interest, etc., has corresponded so closely to ethical and economic requirements that no corrective, supplementary distribution is necessary or possible. The profit-sharing arrangement has become a test and measure of the rightness of

the preliminary distribution in wages. The chances are, however, that the disappearance of the *bonus* indicates that the basis of division is a wrong one.

Finally, there is no valid objection to profit-sharing in the possibility that, of two profit-sharing corporations, one, managed by a head of great ability, may make large dividends for employees in addition to large dividends for stockholders, while the other, badly managed, pays little to stockholders and nothing to employees beyond their wages, although, under the stimulus of expected dividends, the latter have worked as faithfully as the employees of the more successful corporation. The assumption that in such a case, equal work would receive unequal rewards is untrue, because the unequal rewards would sift the workmen. The best workmen would find their way into the employ of the prosperous concern, the inferior workmen would be left to the unprosperous one. The assumption that the slack or dull-witted employer would institute profit-sharing at all is humorous. The assumption that any part of the profit that has been created by the ability of the manager could go to anybody but the manager, without violating the ethical principles of profit-sharing itself, betrays a theoretical misconception. If wealth created by the manager goes to somebody else, it shows, not that profit-sharing is wrong, but that the manager's salary is less than he earns.

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ENGLISH LABOR STATISTICS.

Important steps have been taken by the English Board of Trade for the publication of labor statistics, under the resolution of the House of Commons of March 3, 1886. That resolution, it may be remembered, was introduced by Mr. Bradlaugh, and led to an animated discussion, in which the failure thus far to present in the government publications any trustworthy information as to the real condition of the laboring class was distinctly brought out by more than one speaker, the House finally resolving in favor of immediate steps to